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Dundee Discussion Papers in Economics

Brand Building and Structural Change in the Scotch Whisky Industry

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BRAND BUILDING AND STRUCTURAL CHANGE IN THE SCOTCH WHISKY INDUSTRY SINCE 1975

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1. Introduction

The Scotch whisky industry has undergone fundamental changes in both organisation and structure since the late 1970s. Faced with a global stagnation and a significant decline in consumption in traditional markets, firms have switched from a production-driven to a market-driven approach in an attempt to raise profits through enhanced margins. The main emphasis of the new strategy has been on adding value through building brands, with careful price positioning, increased investment in advertising and distribution, and attempts to persuade customers to buy better rather than buy more, being seen as the key to success.

Whether the changes that have taken place in recent years are either radical or capable of yielding a sustained improvement in returns is a matter for debate.

Morgan and Moss have argued that modern whisky marketing techniques are not fundamentally new, merely more sophisticated. Indeed, they maintain that nineteenth century whisky marketers were well ahead of their time and possessed an intuitive understanding of the demographic and psychographic techniques that Tedlow has associated with marketing in the second half of the twentieth century.¹ The effectiveness of the new marketing strategies has also been called into question by Weir who, in 1994, suggested that the improved profitability of the dominant

firm, United Distillers, was the result of rationalisation following the Guinness takeover of 1986, not improved brand management.²

There is doubtless more than an element of truth in these assertions. At the same time, these scholars appear not to have recognized the full extent of the changes in marketing strategy since the 1970s, or their implications for firm and industry structure. Indeed, the strategy of adding brand value should not be regarded as simply more of the same, but as a conscious attempt to integrate the four main elements of the marketing mix, namely product, price, promotion and place, in new and far more effective ways.³ Improvements in market research theory and practice have been crucial to this development.

The new strategy has entailed not only changes in the approach to marketing, but changes in organisational structure too. The key change has been one of forward integration, with leading firms acquiring formerly independent distributors so as to acquire more market information, exercise greater control over the marketing mix, and capture the rents from effective brand management. Substantial merger and joint venture activity has also taken place as major players in the international wines and spirits industry have combined both to reap the benefit of economies of scale and scope in distributing a wider portfolio of alcoholic beverages, and to round out market coverage on a global basis.

2. A production driven industry

The structure of the post-war Scotch whisky industry changed little prior to the 1970s when a process of consolidation began.⁴ Even so, by 1980 the ownership of 120 or so malt and 10 grain whisky distilleries was still divided amongst forty concerns. The dominant firm, The Distillers Company Ltd. (DCL) owned almost half of the malt whisky distilleries while Hiram Walker & Sons and Seagram Distillers, both Canadian companies, owned a further 18 between them. Other leading concerns included Highland Distilleries, Grand Metropolitan subsidiary International Distillers & Vintners (IDV), Arthur Bell & Sons, and William Grant and Sons, all of which owned around 5 distilleries each. These major distillers also blended and bottled whisky although a number of concerns without distilleries also bought in, blended, bottled and branded their own products. DCL, IDV and others also produced and marketed gin.⁵

The 1960's and 1970's represented a 'golden age' for the Scotch whisky industry. Consumption in traditional markets of the United States and Britain rose fairly steadily while new whisky drinkers in the European Community and Japan also boosted sales. (See below, Table 1) Between 1965 and 1980 demand grew at around nine per cent per annum although progress was periodically halted by downturns in the world economy. Output peaked at 476 m. LPA before being checked by the world recession in 1975. The subsequent recovery was somewhat halting, especially in the United States and Britain where changing tastes in alcoholic beverages,

Table 1**Major Markets for Scotch Whisky, 1970 - 1996**

	1970		1980		1990		1996	
	m. LPA	%	m. LPA	%	m. LPA	%	m. LPA	%
U.S.A.	86.68	41.2	74.97	24.7	46.24	16.2	33.73	11.7
U.K.	27.34	12.3	50.14	16.5	41.34	14.5	32.07	11.1
Japan	2.93	1.4	27.96	9.2	20.97	7.3	10.91	3.8
E.C. 6	21.46	10.2	51.56	16.9	51.04	17.9	61.40	21.2
Other	72.09	34.2	99.15	32.6	125.7	44.1	150.77	52.2
Total	210.5	100.0	303.78	100.0	285.29	100.0	288.88	100.0

Sources: D.B. Small & L.D. Smith, 'The Food, Drink and Tobacco Industry' in Neil Hood & Stephen Young, eds, *Industry, Policy and the Scottish Economy*, Edinburgh 1984, p. 196; SWIR 1997: 24, 51.

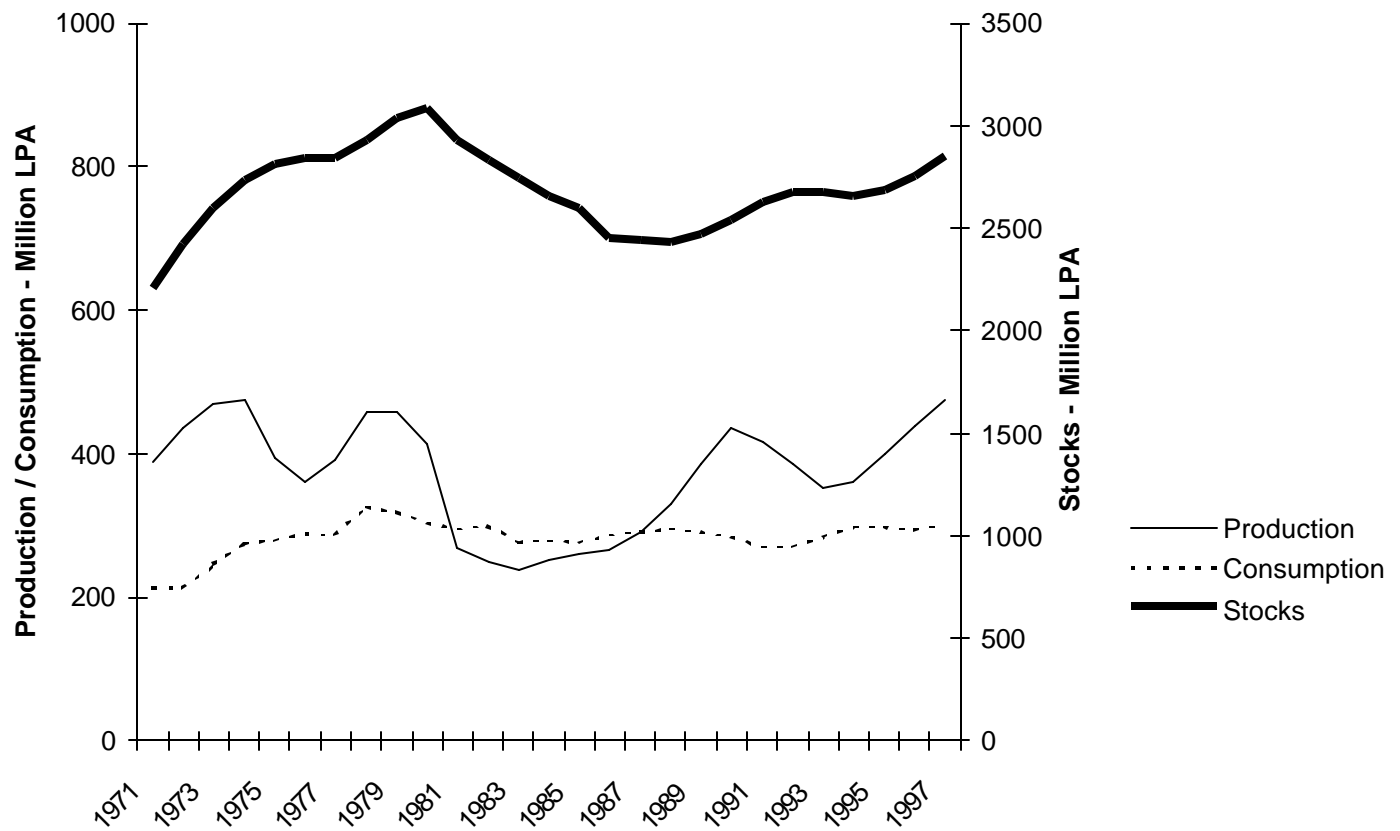
drink driving laws, and a trend towards healthier living marked the beginning of a long-term decline in whisky consumption. (see below, Figure 1) Stocks however continued to rise until by 1980 they were equivalent to more than ten years production. Moves to trim capacity began that year when short-time working was introduced, with lay-offs and distillery closures following as the scale of the problem became evident. By 1986 around a quarter of all distilleries had gone out of production.⁶

The surplus capacity problems that arose were partly the result of the production orientation of the industry. The rapid growth of demand to the mid 1970s had

encouraged management to rebuild old distilleries, erect new ones, and construct additional packaging and bottling facilities.⁷ Preoccupied with raising output, they paid little attention to marketing and the fact that customers' tastes were changing.

Figure 1

Production, consumption and stock levels, 1971-1998 (million LPA)



Sources: alculated from *SWIR*, annual volumes.

3. Traditional marketing methods

The marketing and distribution of whisky changed little during the 1960s and 1970s, notwithstanding the increased volumes handled. Many of the smaller distillers continued to supply blenders with fillers, with limited quantities of their single malts being bottled and marketed either by blenders or by wine and spirits merchants. The larger blenders such as Berry Brothers & Rudd, Robertson & Baxter Ltd., and major distillers and blenders including Arthur Bell & Sons, Seagram Distillers, IDV group, and DCL sold their output through a number of marketing subsidiaries. In the case of the three latter concerns, a history of growth through acquisition resulted in their portfolio of brands being marketed by brand-owning subsidiaries. Indeed, the blending and marketing operations of the dominant firm, DCL, was divided up amongst almost 40 subsidiary companies, including such notable brand owners as John Dewar & Sons, John Haig & Co., John Walker & Sons, and White Horse Distillers Ltd.⁸

The diffusion of brand-ownership and management within leading companies meant that, even had more attention been paid to marketing, it would have been extremely difficult to maximise the returns from brands. DCL, with its many subsidiaries, suffered more than most. Centralised marketing had been considered and rejected by management between the wars, with companies such as Dewars and White Horse continuing to compete in all areas of the marketing mix except price.⁹ Similar problems existed within the IDV group where, despite lip service being paid to the importance of brands, there were few

attempts made to rationalise activities and build international brands. Instead, group companies resembled 'an uneasy confederation of fiefdoms, each one at odds with the others'.¹⁰

The lack of central direction and coordination meant that it was difficult for the larger firms to develop integrated marketing plans that involved matching individual brand profiles with a particular market segment. The use of agents to promote and distribute products, both at home and abroad, necessarily made matters worse. In 1978, DCL felt obliged to defend the system of agency.

'Scotch whisky is exported to some 180 countries, in which the problems of competition, discriminatory legislation and taxation vary so enormously, and no brand owner could compete effectively in all these diverse markets other than by coming to an agreement with a local distributor which offers the distributor the necessary incentives to fulfil his obligations.'¹¹

The agreements drawn up between companies and distributors usually specified pricing regimes, sales targets, packaging, advertising allowances etc., and these were monitored by export directors and sales representatives of the various brand owning companies who travelled the world.¹²

The fact that brand-owning subsidiaries often used competing agencies to market their products clearly made the life hard for peripatetic sales directors. But there were other aspects of these arms-length relationships that often militated against effective brand management. Firstly, it was inevitable that

principal-agent problems arose, with brand-owning companies simply unable to monitor the large number of agents in an effective manner. Secondly, contracts concerning promotion and distribution were often difficult to specify and enforce. This afforded considerable scope for opportunistic behavior with disputes commonplace. Lastly, the use of agents meant that brand-owners were not particularly close to the customer, with United Kingdom based marketing departments reliant on overseas agents for advice concerning when and how to adjust their marketing mix. It is evident that imperfect information flows inhibited both new marketing initiatives and product development.

The downturn in sales in the late 1970s necessarily raised questions about traditional methods of marketing whisky. By the early 1980s even the most backward of firms regarded the system of agency as an impediment to the introduction of more modern marketing methods.¹³

4. Market Research

For many years brand owners had sought to differentiate their products not only on the basis of price, taste, and colour, but also through brand names, packaging, and promotions designed to appeal particular market segments. It is these activities that have led to the suggestion that whisky marketing was relatively sophisticated.¹⁴ Yet while distinctive brand names and labelling may well have provided various groups of consumers with certain emotional benefits, it is clear that knowledge of market segmentation and brand building was still

rudimentary. This was due in no small measure to the nature of market research prior to the 1980s.

Much research and promotional activity in the industry had traditionally been handled by advertising agencies that operated in an environment in which reputations were often based on market share and creative talent.¹⁵ That creative talent rather effective market research should be the main criterion for judging agencies is hardly surprising because, until mid-1970s, they simply did not possess the tools with which to identify market segments, the nature of functional and psychological benefits sought by each, or the effects that changes in the marketing mix might have upon consumption. Thus while agencies might be well aware that advertising material that showed ‘the most manly face above the most reassuring kilt’ was having little impact on the ‘under 40’s market’, their response would be guided by experience and intuition rather than research.¹⁶

The early type of research carried out is perhaps exemplified by that undertaken in 1966 by NOP for David Macaulay Advertising Ltd. who had been engaged by William Teacher & Sons Ltd. NOP were instructed conduct a survey of whisky consumers in the United Kingdom stratified by age, sex and region. Consumers were asked what brands they were familiar with, where, when and in what quantities they might purchase whisky, and what their favourite brands might be.¹⁷ The information obtained by this simple behavioural and geo-demographic profiling

exercise would clearly have been of assistance in terms of scheduling and distribution. Yet whether consumers received or wished for any other benefits from whisky, apart from purely functional, could not possibly have been established by this type of survey.

The realisation that additional benefits were important to consumers, and that these might be better understood by researching their lifestyles, as reflected in activities, interests, and opinions, was formally incorporated into marketing theory by Plummer and others in the mid-1970s.¹⁸ The view that lifestyles had a major impact on consumer choice was, of course, hardly alien to the advertising industry. During the 1970's Bill Bernback of DBB, the New York agency employed by Chivas Regal to advertise and promote their products, urged his clients to accept advertisements that 'live in the current idiom'.¹⁹ With advances in marketing theory, agencies were now provided with a methodology with which to help them understand what constituted the 'current idiom' for different market segments.

In 1978 Haddows, who now held the William Teacher & Sons' account, reflected changes advertising practice when they set up a qualitative research group to examine attitudes and reactions to a UK promotion they had run. The core proposition of the promotion was that the company's leading blended whisky, 'Highland Cream', was superior to that of rivals. It was substantiated by material that emphasised the high malt content and superior quality of the blend. The responses probed for were that consumers *knew* that 'Highland Cream' contained more malt

than other popular blends, *believed* that the smooth taste was worth a relatively higher price, and *felt* that the whisky was consumed by discerning drinkers. These beliefs and feelings were important because Haddows, through their media buying, were intending to target not only the traditional A & B market segments, but younger and aspirational C1s and C2s.²⁰

The use of a research-validated proposition that, although stressing functional benefits, offered other benefits to a particular market segment, represented an advance in the approach to marketing over those employed by David Macaulay Advertising in the late 1960s. Nevertheless, Haddows did not attempt to engage in the type of psychological profiling that was characteristic of much subsequent research into the values and lifestyles held by consumers of alcoholic beverages. The major breakthrough in this direction came in 1979 when SRI International developed their VALS methodology which sought to segment markets by researching both the cultural values and lifestyles of consumers. The exercise was initially applied the United States of America where some eight types of consumers were identified, 'each so distinctive in its behavioural and its emotional makeup' as to constitute specific market segments.²¹

By the mid-1980s the methodology had been adapted for use in Great Britain. Henceforth market research agencies began to explore the type of psychological needs and benefits sought by different types of consumers, typically through extended creativity exercises conducted with series of focus groups, stratified by

position in the lifecycle, social grade, and region. The first notable alcoholic beverages study was that conducted for IDV in 1983, examining consumer responses to 'Smirnoff' vodka. Insights gained from this study provided the basis for a more general survey of the alcoholic drinks market in 1986, with particular reference to IDV wine and spirits brands. The Smirnoff study suggested that there might be five broad groups of consumers, ranging from 'young inexperienced' to 'London trendsetters'. Attitudes were explored in relation to life stage, values, heroes and aspirations, and immediate past and expectations of the future. It was found that each group of consumers clearly identified themselves with the perceived characteristics of the alcoholic beverage they drank. The brand made a statement about them as people.²²

The development in market segmentation methods, which allowed whisky brands to be matched to profiles of different groups of consumers, was essential if brand-owners were to position the brands in their portfolio so as to minimize cannibalisation and maximise returns. It was also essential for changes in the structure of marketing and distribution to take place, for without it many of the increased rents generated by strategy based on effective micro-marketing might be dissipated.

4. The transition to a market-driven industry

The production-driven orientation of the whisky industry was clearly inappropriate given the conditions of the late 1970s, and a number of firms began to consider how

they might adjust their strategy so as to generate profits growth in a declining market. One of the first companies to take action was IDV which, in 1976, appointed a managing director with a strong marketing background. In 1977 the importance of marketing was recognised at board level by the appointment of a Group Marketing Director whose job it was to set priorities and coordinate activities of hitherto separate divisions. This represented an important step forward, not only in terms of recognising the need for more effective marketing, but also in providing those involved with marketing with a champion at board level to argue the case and secure the resources necessary for brand-building.²³

Structural changes soon followed at IDV, with the establishment of a Group Marketing Division at head office. This was to provide support for subsidiary divisions which, while remaining free to meet the idiosyncrasies of their individual markets, were now obliged to operate in line with head office guidelines. The new focus was enshrined in IDV's first formal statement of corporate strategy, which was 'to maximise long-term profit through the marketing of a wide range of profitable brands'. In reality this meant selecting a limited number of brands upon which to concentrate marketing effort, at the same time engaging in new product development so as to exploit arising market opportunities.²⁴

The new strategy embarked upon by IDV involved a significant increase in marketing expenditure, from around £10 millions in the mid-1970s to £30

millions by 1980. Forward integration into distribution also occurred so that the now heavily advertised leading brands might be properly promoted and sold through the appropriate channels. Anthony Tennant, Chief Executive of IDV explained the rationale of this development as follows:

‘Our business strategy also calls for our own operations in key markets, not only to control the marketing of our own brands more effectively and to respond to consumer needs more efficiently, but also to pull through more profits from our investments in productive capacity. We have opened or acquired new businesses in five countries in the last two years, by far the most important being the U.S.A.’

By this stage IDV’s own marketing and distribution outlets were selling 50 per cent of the companies brands worldwide, the company being content to let agencies to handle sales in smaller and less important markets. The strategy appears to have been effective, with IDV group profits increasing 300 per cent between 1977 and 1981.²⁵

The difficult trading conditions in global whisky markets at this time obliged other distillers and blenders to pay more attention to the way in which they marketed their wares. Sometimes they were encouraged to take action as a result of pressures exerted via the capital market. Thus in 1980 Highland Distilleries, which had spent the early 1970s shuffling its agencies in the UK, Europe and the United States, found itself subject to takeover bid from the Canadian owned alcoholic beverages company, Hiram Walker & Sons.

Owing to the impact that a merger might have upon employment in Scotland, the bid was referred to the Merger & Monopolies Commission. In their submission, Hiram Walker claimed that Highland's leading blend, 'The Famous Grouse', would prosper under their stewardship because they had the international sales network that Highland lacked. Fortunately for Highland Distilleries, they were able to get the bid blocked by convincing the MMC there were sound plans for the development of the brand.²⁶ Highland subsequently ended existing agency arrangements in the United States and established their own importing and distribution company.²⁷

The view that many leading distillers and blenders were inept when it came to marketing and distribution gained currency in the city during the early 1980s. These views were exploited by Ernest Saunders of Guinness when, in 1983, he mounted a hostile bid for leading distillers and blenders, Arthur Bell & Sons of Perth, as he sought to strengthen Guinness' presence in the drinks industry. According to Saunders, the whisky company had lost its way. What Bell's needed was the marketing expertise of Guinness in order to revitalise brands at home and 'give it the push required in America and other important overseas markets'. This time the bid was not blocked on regional employment grounds and Guinness duly acquired the company.²⁸ As it turned out, Bells was unusually well run, offering little opportunity for enhanced earnings through superior brand management.²⁹

Pressures from institutional investors and others also put pressure upon DCL which, faced with the steady erosion of market share, found itself increasingly forced to defend the way in products were sold and distributed. In 1982 consultants were hired to provide the ailing firm with guidance and in the following year a new chairman to the board was appointed. Major changes were undertaken with the existing management structure scrapped, the responsibility for managing leading brands overseas given to individual marketing executives, a home trade division created to handle all domestic whisky sales, and a new products division established.³⁰ It was all regarded as being 'too little and too late' and by 1985 DCL was seen as a prime target for takeover.

During the summer of 1985 speculation mounted concerning the future of DCL. A brief flirtation between the company and Allied-Lyons (itself being stalked by the Australian conglomerate, IXL, for its brewing interests) came to nothing, with Allied-Lyons subsequently broadening its liquor business through the purchase of Hiram Walker & Sons. More concrete evidence of interest in DCL came in September when James Gulliver, the chairman of food and drinks group, Argyll, agreed with the U.K. takeover panel to defer a bid for the company until the 2nd December. When it came, the highly leveraged bid worth £1.9 billions was rejected as both unwelcome and inadequate. DCL suggested, with some effrontery, that 'Argyll's record in Scotch whisky to date has shown a lack of strategic direction, a lack of understanding of brand management, and a lack of commitment to the industry'.³¹

DCL's board immediately prepared to defend themselves, attempting to bolster their share price by boosting sales through heavy discounting and exploring the possibility of disposing of a number of leading brands.³² Despite these measures, it appears that DCL felt that the prospects for retaining their independence were slim.

Consequently, when the Office of Fair Trading cleared Argyll's bid, DCL decided that they were willing to accept approaches from other parties rather than surrender to James Gulliver. Ernest Saunders of Guinness rapidly stepped in. Faced with a golden opportunity for applying Guinness's brand management skills to underperforming assets and, in the process, transforming his company into a leading international drinks concern, he mounted a counter-bid of £2.2 billions.

During the early months of 1986 the British public witnessed campaign of unprecedented viciousness between Argyll and Guinness. Much of the debate was carried on in the press and focussed on the ability of the rival parties to extract value from DCL's under-exploited portfolio of leading brands. Saunders was particularly vociferous, talking endlessly 'about his marketing pedigree, how his knowledge of that art/science can breath new life into flagging brands like Horlicks, Lucozade, or the black stout itself...[and] the same for whisky'.³³ DCL, now backing Guinness, also weighed in, sending shareholders a mass of charts and statistical data purporting to show how 'Argyll lacks experience in brand management', whereas 'Premium Brand Management' was the 'hallmark of Guinness' success'.³⁴

After a further bidding round, Guinness finally secured control of DCL in April, 1986 with a bid, involving an exchange of shares, of £2.3 billions. In the event, Guinness success had less to do with shareholders' judgements concerning the relative marketing competence of the two protagonists as to the illegal manipulation of Guinness share price by Saunders. Irrespective of the outcome, however, the battle of the brand-builders signified, in terms of corporate culture, that the Scotch whisky had finally made the transition from a production driven to a market driven industry.

5. UDG adopts IDV's market-driven strategy.

The acquisition of DCL by Guinness resulted in a significant re-shuffling of brand ownership in order to satisfy competition authorities. Even after divestments of leading brands such as Haig and Claymore, United Distillers (UDG), as the spirits subsidiary of Guinness PLC was now called, still commanded almost 40 per cent of the world market for Scotch whisky.³⁵

The emergence of this new whisky giant was broadly welcomed by the industry, notwithstanding the competitive threat that it posed. Most felt that UDG would provide more dynamic leadership than DCL, especially with respect to prices where its commitment to add value to brands had obvious ramifications for pricing structures. Before prices could be lifted, however, the question of the industry's excess stocks had to be addressed. UDG, which held the bulk of the surplus whisky,

adopted a policy of using stocks ‘in a sensible and controlled fashion’, and by 1990 the problem of excess stocks had been virtually eliminated.³⁶

The orderly reduction of stock was an essential prerequisite to adding value through building brands, for it would be difficult to extract price premiums in an environment of heavy discounting. Even more important, however, was the development of an organisational structure that enabled this strategy to be implemented effectively.

The appropriate structure was put in place not by Ernest Saunders, now on his way to jail for the illegal manipulation of the his company’s share price, but by Guinness’s new group chief executive Anthony Tennant. Tennant, formerly of IDV, was appointed early in 1987.³⁷ Not surprisingly, the structure that emerged was not dissimilar to that which had been so successfully embraced by IDV in the late 1970s.

To provide a more coherent and focussed approach to marketing and sales, Tennant replaced the old company system of brand management with four marketing divisions that each dealt with a particular area of the globe. This prevented inter-brand competition and, with each division able to provide distributors with a complete range of UDG brands, allowed the company to forge closer relationships with their customers. The divisional marketing and sales team were provided with support by a newly created Central Strategic Marketing and Business Development Unit which, as at IDV, was responsible for the positioning and overall marketing direction of major brands, long term investment, line extensions and new product development.³⁸

The key to efficient brand building lay not only in supplying customers with a optimally positioned range of brands, however, but also in ensuring that, downstream, products were properly promoted and distributed. In 1987 a process of rationalisation began, with UDG acquiring some agencies, taking an equity position in others, and terminating agreements with many more. Replacing independent.

Table 2

Distributor Rationalisation, 1986 – 1989

Region	1986		1988		1989	
	owned	agents	owned	agents	owned	agents
Asia Pacific	0	221	14	149	16	73
Europe (1)	2	244	12	237	18	27
International (2)	0	508	0	475	0	273
N. America	1	31	3	13	3	7
Total (3)	3	1304	29	1105	37	470

Source: James Capel, *United Distillers Group*, London 1988: 25 Notes: (1) includes the United Kingdom. (2) broadly speaking, Africa, the Middle East and Latin America. (3) includes Duty Free.

distributors was not entirely straightforward, with UDG obliged to retain existing in agents in some markets for fear of disrupting sales. Forward integration, however, did not always represent the least cost mode of distribution since markets in Africa, Latin America, and the Middle East were often too small or too unstable to warrant

direct investment.³⁹ Here existing distributors were retained. By 1988 UDG controlled over 75 per cent of its distribution network, compared to 25 per cent a year earlier. Further consolidation occurred thereafter.⁴⁰

UDG also sought to enhance its brand portfolio and distribution network through the establishment of joint ventures with other distributors and owners of complementary brands. The most notable of these was with Louis Vuitton Moët-Hennessy (LMVH) with whom UDG entered into a worldwide distribution arrangement. The link with LMVH was beneficial in a number of respects, quite apart from sharing risks. Firstly it strengthened UDG's product range through the addition of leading cognac and champagne brands. Secondly, there were important economies of scale and scope to be had by marketing joint venture products through a common distribution system. Thirdly, it allowed UDG to strengthen its distribution system in places such as South East Asia in which it had previously been weak. Finally, it enabled the company to tap into LMVH's expertise in marketing premium brands through exclusive outlets, vital as UDG sought to move its consumers upmarket. More joint ventures followed, including arrangements with Bacardi to distribute in Spain, with the German schnapps company, Underberg, and with other firms in both Europe and the Far East.⁴¹

Attention to the 'place' element in the marketing mix did not only involve ensuring that products were distributed on a global basis through appropriate outlets. It also required outbound logistics systems that delivered the appropriate quantities of the

various brands in a timely fashion. An important step in this direction occurred early in the reorganisation of UDG with the creation of a Central Stock and Sales Department to monitor and control group stocks. This was followed in 1988 by the opening of a fully computerised Export Administration Centre in Glasgow. Continued improvements in supply chain systems together with investment in packaging and warehouse technology steadily cut down delivery times until, by 1993, they had been cut from six weeks to ten days for Europe.⁴²

The benefits flowing from changes in UDG's strategy and structure began to be felt almost immediately, with profits almost doubling between 1987 and the end of 1990. Cost savings due to the rationalisation of production and distribution, some of which were essentially one-off, played a major part in this improvement.⁴³ By the middle of 1990, however, it was evident that attempts to add value by building brands was also beginning to pay off, with customers willing both to pay more for their whisky and to trade up to more expensive brands. With scope for further cost savings limited, it was anticipated that brand-led marketing would take over as the main driver of profits growth.⁴⁴

6. Other Alliances and Acquisitions

Scale is important in the international drinks industry, an annual turnover of 10 million cases supposedly being the minimum required to support a worldwide network of distributors.⁴⁵ IDV, with a rounded drinks portfolio of spirits, branded wines and liqueurs, had reached a figure of some 40 million cases a year by 1987,

with the newly reconstituted UDG and Seagrams close behind.⁴⁶ By this stage, all three had taken control of a sizeable proportion of their distribution through a combination of acquisition and joint ventures.

Other firms, concerned by the competitive threat posed by these developments, felt obliged to mount a strategic response so that they, too, might enjoy the benefits of scale, more efficient distribution, and a balanced portfolio of alcoholic beverages. In 1987, food and drinks group Allied-Lyons, hitherto weak in whisky, acquired the whisky interests of North American based Hiram Walker, owners of the world's third biggest selling blend, Ballantines. Although this lifted Allied's total case sales to over 30 millions annually, they continued on the acquisition trail and in 1989 purchased the wine and spirits interests of the brewer, Whitbread, which was exiting the industry. Added to the Allied portfolio were the Long John and Cutty Sark blends, Laphroig single malt, plus other brands, together with the expertise of US importers and distributors, Buckingham Wile.⁴⁷

Smaller firms were less well placed to extract the full benefits from global marketing. Even so, attempts were made to improve distribution through establishing joint ventures and other links with major international drinks companies. Whyte & Mackay, owned by Lonrho since 1976, had reciprocal agency agreements with American Brands, owner of Jim Beam. In 1989 the company was acquired by American Brands, by that stage the third largest distiller in the United States. Macdonald Martin (Glenmorangie) also forged a

connection with a major liquor group, Brown-Forman, owner of Jack Daniels and distributor of Southern Comfort, while Highland Distilleries developed global marketing arrangements with French firm, Remy Cointreau, with an exchange of shares taking place. A number of other small distillery companies were wholly or largely owned by major overseas drinks firms such as Pernod Ricard and Suntory.⁴⁸

During the 1980s, therefore, the structure and organisation of the Scotch whisky industry underwent major changes, with the market share of the top 5 firms increasing from 64 per cent of total case sales in 1982 to 77 per cent by 1990. Large firms grew as, through a process of acquisition and forward integration, they sought to reap the marketing and scale advantages afforded by global distribution. Smaller distillers attempted to counter these initiatives by forging links with other international drinks companies so that they, too, might achieve distributional savings and offer Scotch as part of a wider portfolio of alcoholic beverages.

7. The role of strategy in recovery

The changes that took place in the strategy and structure of the whisky industry in the mid-1980s appear to have coincided with an improvement in profitability. The share prices of distillers and blenders, languishing between 1982 and 1986, recovered towards the close of the decade, generally outperforming the UK all-share index by a significant margin. But was this recovery in fortunes directly attributable to the strategic initiatives aimed at adding value, or was it the result of a strengthening world market which UDG helped to support through its careful sell-down of excess stocks?

The fact that world consumption started to increase in 1986 prior to the changes in strategy and structure doubtless helped to underpin a recovery in the industry. The evidence suggests, however, the changes put in place did help to raise real prices, even in the United States and United Kingdom where consumption continued to fall. The inflationary environment, in which nominal prices were constantly rising, assisted the process of price adjustments.

Price and cost data are subject to a number of deficiencies, with averaging procedures, discounts, and allowances necessarily distorting the picture. Bearing these deficiencies in mind, however, the data shows that between 1986 and 1990 the net export prices for standard blend whiskies increased faster than production costs. As a result, gross margins rose from 47.4 per cent to 52.2 per cent during this period. Forward integration and the assumption of promotion and distribution nevertheless

did entail additional selling costs, and these tended to offset higher gross margins, especially during the downturn of the early 1990s. (see Table 3, below)

Table 3

Costs, Prices and Margins - Standard Blend: 1982 – 1996 (£ per case)

	1982	1986	1990	1992	1996
Production Costs	7.60	9.59	11.69	12.36	13.19
Export Price	14.56	18.25	24.63	29.81	33.02
Gross Margin	6.96	8.66	12.94	17.45	19.83
Gross margin as a % of P	47.8	47.4	52.5	58.5	60.1
Selling Costs	2.34	3.50	5.00	8.00	10.00
Total Costs	9.94	13.09	16.69	20.36	23.19
SC as % TC	23.5	26.7	30.0	39.3	43.1
Net margin (P – TC)	4.62	5.16	7.94	9.45	9.83
Net margin as a % of P	31.7	28.3	32.2	31.7	29.8

Source: Estimates based on data contained in *SWIR*, 1990 & 1997, Table VI

Note: The data probably understates the true increase in gross margins as discounting declined as the market firmed.

Raising prices was but one marketing objective, the other being to persuade customers to trade up to higher margin premium products. Here firms also appear to have been successful. Between 1986 and 1990 the sales of blended whisky bottled

in Scotland increased from 70.5 per cent to 75 per cent, while sales of top of the range bottled malts increased from 2.7 per cent to 3.9 per cent. The trading up process also appears to have occurred within categories, with customers buying a higher proportion of up-market blended whiskies. In the late eighties, consumption of the top ten leading blends increased from around 48 to 53 per cent.⁴⁹

The adoption of a brand-driven strategy thus appears to have played a significant part in raising prices and profitability. As in other consumer goods industries, brand values were now included in balance sheets as intangible assets. This new faith in brand building, together with the upturn in trade, gave rise to considerable optimism in the Scotch whisky industry, with twelve malt distilleries being re-opened between 1989 and 1991.

8. A challenge to brand building

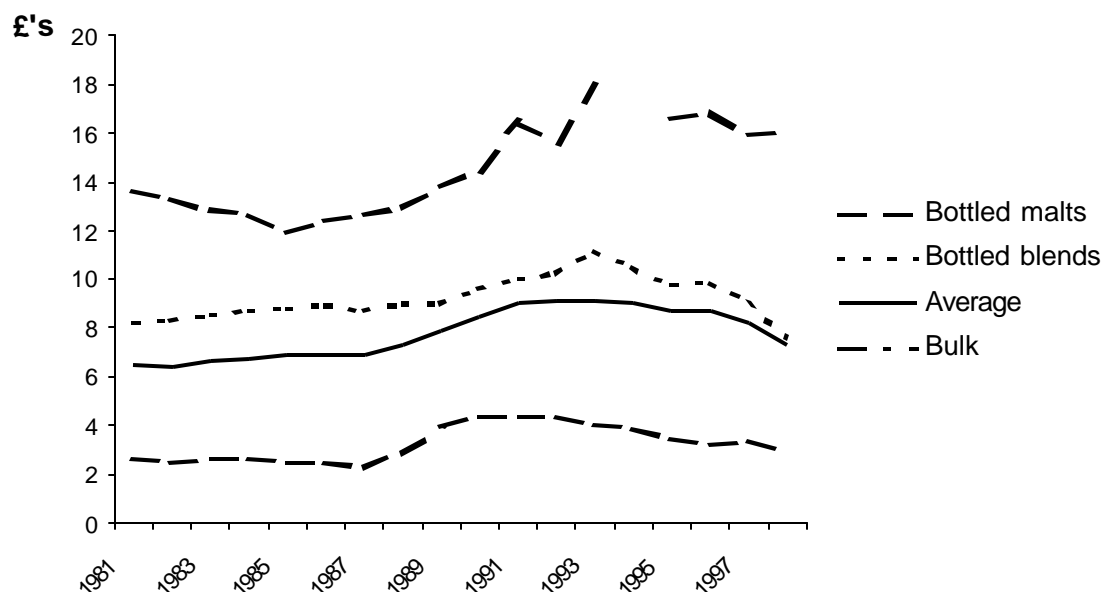
The optimism exhibited in the late 1980s appears to have been premature for the world recession that began in 1990 saw annual consumption of Scotch fall by almost 20 million LPA in two years. Stocks began to soar again with the result that distillers progressively cut output until by 1994 the industry was working at 70 per cent total capacity. Complaints about overproduction, difficult trading and declining profits became commonplace.⁵⁰

The recession posed a severe challenge to the strategy of adding value through brand building. The reaction of UDG, as dominant firm in the industry, was

crucial, and initially the company stuck to its policy of ‘confident pricing’, maintaining margins and increasing profits notwithstanding growing trading difficulties. By 1992, however, recession-hit customers were beginning to trade down and UDG began to lose market share, especially in value-for-money brands into which it had hitherto put little marketing effort. The following year saw a subtle change in the company’s marketing mix, with a cut in advertising expenditure and the commitment to raising prices being qualified by a call for a more ‘thoughtful’ and careful approach to pricing. This announcement, during a time of recession, was a clear signal on the part of the market leader that it intended to chase volumes and engage in widespread price competition.⁵¹

UDG’s action appears to have affected all sectors of the market, with export prices f.o.b trending down even though sterling had weakened. (see Figure 2, below) Competition was also acute in the UK where the company held the nominal price of its premium blend, ‘Bell’s Extra Special’ at around the same level from 1962 to 1966, discounting heavily at Christmas time. Despite aggressive pricing, UDG was unable to prevent its share of world markets falling from almost 37 per cent in 1992 to 33.5 per cent in 1995. Worse still, over the same period margins slipped from 31 to 26 per cent, notwithstanding ongoing rationalisation of production and distribution. In 1995 the company

Figure 2

Whisky export prices per litre of pure alcohol, 1981-1998 (1995 prices)*

Source: *The Drink Forecast*, 1999, Volume 19, No. 3, 244-5 *Includes N. Irish whisky.

conceded that the policy of price competition was both misguided and unsuccessful. It was time to return to the newly discovered virtues of raising prices through building brands.⁵²

The announcement that the market leader was to resume its brand-building strategy welcomed by the rest of the industry. Restoring brand values and raising prices, however, was easier said than done. Firstly, the Asian downturn of the late 1990's and the appreciation of sterling against continental currencies resulted meant that market conditions made it difficult to raise prices to previous levels. Secondly, and more seriously, UDG found that brand building was not a

short-term strategy. Once brand values had been stripped away and consumers had become habituated to cheap Scotch, it was difficult to persuade them to pay a price premium once again. UDG sought to repair the damage by repositioning and relaunching both the Bell's and Dewars' brands, this being followed up in 1996 by a double-digit increase in marketing investment, and a 25 per cent increase in media spend. Attention was to be focussed on five key Scotch and gin brands.⁵³

The difficulties faced by the industry in restoring profitability through organic growth were reflected in share prices, which lagged behind the market. In 1997 the management of Guinness decided to pursue an alternative yet complementary strategy for growth, a merger with old rivals Grand Metropolitan, owners of IDV. There were clear operating advantages from merging functions, with anticipated annual cost savings of £175 millions. There would also be better geographic coverage of markets. But the main advantage of the merger was that it combined UDG's strength in whisky and gin brands with IDV's strength in vodka, liqueurs and tequila. Diageo, as the new creation was to be called, would possess an outstanding portfolio of world class brands. It also would inherit Grand Metropolitan's packaged food brands, a somewhat less appealing proposition.⁵⁴

The merger was finalised in May 1997, although Diageo was obliged to divest itself of certain brands to satisfy competition authorities. Ultimately Dewar's

whisky and Bombay Gin were sold to Bacardi. In the process of refining its brand portfolio, Diageo also began to sell off non-performing brands that did not satisfy rate of return criteria. At the same time it sought to acquire other leading drinks brands as the opportunity arose, joining with Pernod Ricard to acquire Seagram's brands as the latter exited the industry. Part of the deal involved Diageo selling off its 'Malibu' coconut rum brand to rivals Allied-Domecq.⁵⁵ These transactions represented further consolidation of the drinks industry as leading companies sought to add value by acquiring as well as building world class brands.

9. Conclusion

The suggestion that the adoption of a brand-based market driven strategy by the Scotch whisky industry had been foreshadowed by earlier developments, or was merely a transient phase in the evolution of the industry, would seem to be misplaced. A major cultural shift took place from the late 1970s onwards, as brand building became the strategy around which companies sought to restructure their activities. The impetus for the change was brought about by stagnation in global consumption and innovations in marketing methods that provided greater insights into consumer choice. This encouraged companies to segment markets more effectively, and to adjust all facets of their marketing mix so that they might maximise returns from the various market segments. The development of marketing competencies encouraged them to operate on global

basis, and to think in terms of exploiting comprehensive portfolios of leading drinks brands that had international appeal.⁵⁶

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¹ N. Morgan & M. Moss, 'The marketing of Scotch: a historical perspective', in R. Tedlow & G. Jones, eds, *The Rise and Fall of Mass Marketing*, London, 1993, 126-130.

² R.N. Weir, 'Managing Decline: brands marketing in two mergers, 'The Big Amalgamation, 1925' and Guinness DCL in 1986' in G. Jones & N. Morgan, eds. *Adding Value; brands and marketing in food and drink*, London 1994, 159.

³ For a critical review of the concept of the market mix, see H. Gronroos, 'Quo Vadis Marketing...'
Journal of Marketing Management, v. ' 1994, 347-60.

⁴ Michael S. Moss & John R. Hume, *The Making of Scotch Whisky*, (Edinburgh 1981), 175-177.

⁵ Philip Morrice, *The Schweppes Guide to Scotch*, (Sherbourne, 1983), 75-82.

⁶ *Quarterly Economic Commentary*, 1980, Vol. 6, No. 3, 11; 1985, Vol. 10, No. 3, 26-7.

⁷ Moss & Hume, 182-9.

⁸ Morrice, 1983, 211

⁹ Weir, 1994, 153-55

¹⁰ James Espey, 'A Multinational Approach to New Product Development', *European Journal of Marketing*, 1985, Vol. 19, No. 3, 7.

¹¹ Distillers Company Ltd., Annual Report (hereafter DCL AR), 27.

¹² DCL AR, 1977, 26; Espey, Speech to Marketing Society, 21.7.1998.

¹³ Letter to DCL shareholders, 21st May 1984.

¹⁴ Morgan & Moss, 126-7.

¹⁵ Mintzberg & Quinn, 804?

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- ¹⁶ Report, David Macaulay Advertising to William Teacher & Sons, 1962. UDG 306/2/1/18/44, University of Glasgow Archives & Business Records Centre.
- ¹⁷ UDG 30b 2/1/24/17, University of Glasgow Archives.
- ¹⁸ Joseph T. Plummer, 'The Concept and Application of Life Style Segmentation, *Journal of Marketing*, 1974, v. 38, 34.
- ¹⁹ Doyle, Bane, Bernback Co. advertising account, Chivas Regal Archives, Strathisla Distillery.
- ²⁰ UDG 396 2/1/24/19, Glasgow University Archives.
- ²¹ David L. Loudon & Albert J. Della Bitta, *Consumer Behavior: Concepts and Applications*, 4th edition (New York), xxxx, 103.
- ²² Susie Fisher Associates, 'An Atlas of the Drinks Market', 1-33, in *Competition between Alcoholic Drinks*, Scotch Whisky Association, Edinburgh, 1991. These methods were rapidly adopted elsewhere. By 1990 Chivas Regal was comparing its profile with that of the competition, and adjusting it accordingly. Brand Communication Manual, Chivas Regal Archives..
- ²³ James Espey, 'A Multinational Approach' , 7-8
- ²⁴ Ibid.
- ²⁵ Grand Metropolitan Annual Report, 1981, 19.
- ²⁶ J.H. Love, *Quarterly Economic Comment*, Vol. 11, No. 1, 1983, 73-4
- ²⁷ Alan S. Gray, *Scotch Whisky Industry Review* (hereafter *SWIR*) 1983, 53.
- ²⁸ Love, 1983, 72-77.
- ²⁹ Morrice, 1983, 118 & 171; *The Scotsman*, 17th April 1986.
- ³⁰ DCL, Letter to Shareholders, 30.12.1985.
- ³¹ J. Gray & M.C.McDermott, *Mega-merger mayhem*, London 1989, 99.
- ³² Letter, *The Scotsman*, 28.2.1986; 5.4.1986.
- ³³ Alf Young, *The Scotsman*, 17.4.1986.
- ³⁴ DCL, Letter to Shareholders, 7.3.1986.
- ³⁵ *SWIR*, 1988, 47.
- ³⁶ *SWIR*, 1991, 28.
- ³⁷ Chairman's Statement, Guinness Annual Report, 1987.
- ³⁸ 'Marketing Changes Keep us in Front', *UD International News*, December 1987, 1-4; Guinness AR 1988, 15.
- ³⁹ For a theoretical rationale for this choice of entry mode, see S. Nicholas

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- ⁴⁰ Guinness AR, 1988, 13.
- ⁴¹ Guinness AR 1987, 6-11; AR 1988, 13; *UD International News*, May 1988, 1-10;
- ⁴² *UD International News*, August 1990, 4; October 1990, 5; September 1993, 3.
- ⁴³ *Financial Times*, 6th October 1989.
- ⁴⁴ *UD International News*, September 1990, 4; March 1991, 1.
- ⁴⁵ Weir, 1994, 156.
- ⁴⁶ James Espey, Brewers & Distillers seminar, November 1987.
- ⁴⁷ *SWIR*, 1988, ; 1990, 20, 56.
- ⁴⁸ *SWIR*, 1994, 68-70, 76.
- ⁴⁹ *SWIR*, annual publications.
- ⁵⁰ *SWIR*, 1993, 28, 51-6; 1996, 158.
- ⁵¹ *UD International News*, March 1993, 3.
- ⁵² *UD International News*, September/October 1995, Guinness World section iii.
- ⁵³ Guinness AR 1994, 12; *UD International News*, October/November 1996, 4.
- ⁵⁴ Listing particulars sent to Guinness and Grand Metropolitan shareholders, 1997. Divestment of food interests has subsequently occurred.
- ⁵⁵ *Independent*, 28th February 2002.
- ⁵⁶ Brand Communication Manual 1991/2, Chivas Regal Archives.